SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 334

JOSEPH E. SEAGRAM & SONS, INC.,
Petitioner,

vs.

THE UNITED STATES.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Official Report of Opinion Below.

The opinion of the Court of Claims is reported in 36 Fed. Sup. 1013 (R. 7).

Jurisdiction.

The jurisdiction of this Court to issue the writ of certiorari is invoked under Section 3 (b) of the Act of February 13, 1925, as amended by the Act of May 22, 1939 (28 U. S. C. A. 288 (b)). The judgment of the Court of Claims, dismissing the petition was entered February 3, 1941 (R. 10). A motion for new trial was filed April 4, 1941, and

denied May 5, 1941 (R. 10), and the time in which this application might be made did not begin to run until after the disposal of such motion on May 4, 1941 (*U. S.* v. *Seminole Nation,* 299 U. S. 417).

Statement.

This action is for the refund or recovery of $1,452.20, same being the Internal Revenue tax of $2.00 per proof gallon on 726.6 proof gallons of spirits, gin, lost and destroyed in petitioner's distillery on August 24, 1936. The loss occurred while such spirits were being pumped or transferred by pipe line from the distillery to the cistern room. Petitioner's employee failed to make the necessary adjustment of the valves controlling the flow of the spirits to the proper tank in the cistern room and, instead of going into a tank which was empty as intended, the spirits ran into a tank which was filled or partly filled resulting in an overflow of 726.6 proof gallons being the loss in question. The loss was promptly reported to the Bureau as required and a claim for the remission of the tax presented which was denied. The tax was then assessed and paid, a claim for refund filed which was also rejected and thereafter this action was brought in the Court of Claims to recover the tax.

The only questions presented are questions of law, it being conceded that the spirits were lost and destroyed in the distillery under the circumstances set forth above. In dismissing the petition, the court held, as stated in the opinion, that the tax became due and was assessed under the provisions of 26 U. S. C. A. 1150 (b); (Sec. 2800 (b) I. R. C.) (*supra,* p. 4), on the theory that the spirits so lost had been "removed from the place where they were distilled and not deposited in bonded warehouse as required by law". It was also held that 26 U. S. C. A. 1197 (Sec. 2846 I. R. C.) (Appendix, p. 22), relating to the distiller's ac-

count for all spirits produced in the distillery on which petitioner relies, had no application to the case at bar.

I.

The court erred in holding that the tax sought to be recovered was due and properly assessed under 26 U. S. C. A. 1150 (b).

26 U. S. C. A. 1150 (b) provides as follows:

> "The tax upon any distilled spirits, removed from the place where they were distilled and not deposited in bonded warehouse as required by law, shall, * * * when knowledge of such fact is obtained by the Commissioner be assessed by him upon the distiller of the same * * *".

It is clear from the above provision that the spirits must be "removed" or taken from the distillery and not deposited in warehouse. This is a logical requirement in view of the provisions of 26 USCA 1171 (Sec. 2820 I.R.C.), viz.,

> "On the third day after the spirits are conveyed into such cistern they shall be drawn off into casks, * * * and be removed directly to the distillery warehouse. * * *".

It is the failure to make this "removal" that authorizes the Commissioner to assess under Section 1150 (b) above. The spirits in question were not "removed from the place where they were distilled" but were lost *in* such place. Section 1150 (b) was section 14 of the original Act of July 20, 1868; section 15 of said original Act provided for the establishment and control of the distillery warehouse (26 USCA 1225) and Section 1171 above requiring the spirits to be removed directly to such warehouse, was section 16 of the original Act. There are other provisions of law which

show conclusively that the spirits must have been in existence *outside* the distillery to give the term "removed" its correct interpretation, if this becomes necessary. 26 USCA 1286 (Sec. 2912 I. R. C.) provides, in part, as follows:

> "All distilled spirits *found* elsewhere than in a distillery * * * not having been removed therefrom according to law, shall be forfeited to the United States".

26 USCA 1287 (Sec. 2913 I. R. C.) provides, in part, as follows:

> "Whenever any person removes, or aids or abets in the removal of any distilled spirits on which the tax has not been paid, to a place other than the distillery warehouse, or other bonded warehouse provided by law * * * he shall be liable to a penalty of double the tax imposed on such distilled spirits so removed * * * and shall be fined * * *".

The similarity of the language used in the above sections to that in Section 1150 (b) is impressive. Other provisions may be mentioned, viz. 26 USCA 1189 (Sec. 2838 I. R. C.) prohibiting the removal of spirits in the absence of the storekeeper-gauger; 26 USCA 1221 (Sec. 2870 I. R. C.) prohibiting the removal of spirits from the distillery "at any time other than after sun-rising and before sun-setting".

As defined by Webster, to "remove" means "to move away from the position occupied; to cause to change place; shift". Applying these definitions to the term "removed" in Section 1150 (b), it would be necessary "to move" the spirits "away from" the distillery, or "to cause" the spirits "to change place" or to "shift" the spirits from the distillery.

II.

The court erred in holding that 26 U. S. C. A. 1197 has no application to the case at bar.

Section 1150 (b) above affords no relief whatever for losses in a distillery if such losses are to be regarded as

"removals" under said section. The spirits lost consisted of gin which concededly had been produced from alcohol previously distilled and was on the way to the cisterns. The Court held that the alcohol having come into existence as such the tax had attached thereto (26 U. S. C. A. 1150 (c)) (Appendix, p. 20) and, having attached, "it must be payable at some time thereafter" (R. 9). Petitioner concedes that the tax had attached but it does not agree that the tax necessarily must be paid thereafter. Section 600 of the "Revenue Act of 1918" (February 24, 1919) as amended by the "Liquor Taxing Act of 1934" (January 11, 1934) provided that the tax was "to be paid by the distiller * * * when withdrawn, and collected under the provisions of existing law" (Appendix, p. 20). As codified in 26 U. S. C. A. 1150 (a) (1) the tax was "to be paid by the distiller * * * when withdrawn from bond" (*supra*, p. 4). Although there is a difference in these provisions, the codifiers undoubtedly intended them to mean the same and that the phrase "withdrawn from bond" covered all that was included in collecting "under the provisions of existing law". In any event, the Court held that the tax was not due or assessed under the above taxing provision because the spirits "had not been deposited in a bonded warehouse" and therefore could not have been "withdrawn from bond" (R. 9). Seeking a provision to warrant the collection of the tax which had previously attached, the Court selected Section 1150 (b) "sinne" as stated in the opinion "there is no provision of law which has been called to our attention, or of which we are aware, that exempts a distiller from payment of the tax because the liquors were lost or destroyed in the process of being removed from the distillery to the cistern room" (R. 9). The "room or building" containing the cisterns is an essential part of the distillery (26 U. S. C. A. 1171; Sec. 2820 I. R. C.) (Appendix, p. 21). A loss occurring "in the process of being removed" from

one part of the distillery to another part of the distillery, which was what happened here, cannot be a "removal" *from* the distillery as required under Section 1150 (b).

All conditions and restrictions surrounding the production of distilled spirits are prescribed by law for the sole purpose of protecting and securing payment of the tax "when withdrawn from bond" or, as now contemplated, when "removed from the place where they were distilled and not deposited in bonded warehouse as required by law". As stated by this Court in *United States* v. *Ulrici,* 111 U. S. 38; 4 S. Ct. 288—

> "It is clear, even from a cursory reading, that the well considered and minute provisions of the Revised Statutes * * * entitled 'Internal Revenue', were adopted with one purpose only, namely, to secure the payment of the tax imposed by law on distilled spirits, and all the penalties, forfeitures, fines, and imprisonments prescribed by the chapter mentioned above have that end in view. If the tax on distilled spirits were repealed, all the ingenious and complicated provisions of the chapter would become useless and insensible."

Avoiding the temptation to follow the course of spirits through the distillery, it will suffice to say that all spirits produced must be conveyed into the cisterns and from there removed to the warehouse (26 U. S. C. A. 1171; Sec. 2820 I. R. C.) (Appendix, p. 21). There is one exception to this rule, however, and it may be material. Under the Act of June 26, 1936 (Sec. 2883 I. R. C.) "spirits produced at registered distilleries and reduced in the receiving cisterns in such distilleries to not more than one hundred and fifty-nine degrees of proof and not less than one hundred degrees of proof * * * may be drawn into approved containers and * * * tax paid in such approved containers in such cistern room, without being entered into an internal revenue bonded warehouse." It was also provided in said Act

(Sec. 2916 I. R. C.) that distillates containing 1 per centum or more of Aldehydes or fusel oil "removed in the course of distillation" pursuant to regulations, could "be removed from such distillery for denaturation or destroyed" and when so denatured or destroyed would not be subject to the tax. Here are spirits which can be "removed from the place where distilled" and are *not* required to be "deposited in warehouse". As to such spirits it is at least doubtful that on removal of such spirits the tax could be assessed under Section 1150 (b).

Under the law a distiller was required to keep a record of all materials used in the distillery, the number of gallons of spirits distilled, the number of gallons placed in warehouse, etc. (26 U. S. C. A. 1192; Sec. 2841 I. R. C.) and to render a monthly report or return thereof to the Collector who forwarded a copy to the Commissioner (26 U. S. C. A. 1195; Sec. 2844 I. R. C.). The producing capacity of the distillery was carefully determined by a "survey" (26 U. S. C. A. 1168; Sec. 2817 I. R. C.) and the Commissioner thereby knew the quantity that could be produced. (This survey requirement has been waived by the Secretary by regulation (T. D. 4794) issued March 11, 1938 pursuant to the above Act of 1936) (Appendix, p. 23), footnote). We now come to the provision of law which, as petitioner contends, exempts a distiller from payment of tax on spirits destroyed in the distillery, namely, 26 U. S. C. A. 1197 (Sec. 2846 I. R. C.) the material portions of which are as follows:

> "On receipt of the distiller's return in each month, the Commissioner shall inquire and determine whether the distiller has accounted for all the grain or molasses used and all the spirits produced by him in the preceding month. If he is satisfied that the distiller has reported all the spirits produced by him, and the quantity reported is found to be less than 80 per centum of the producing capacity of the distillery as estimated according to law, he shall make an assessment for such

> deficiency at the rate of tax imposed by law for every proof gallon. * * * and if the Commissioner shall find that the distiller has used any grain or molasses in excess of the capacity of his distillery * * *, he shall make an assessment against the distiller at the rate of tax imposed by law for every proof gallon of spirits that should have been produced from the grain or molasses used in excess. * * * IF THE COMMISSIONER FINDS THAT THE DISTILLER HAS NOT ACCOUNTED FOR ALL THE SPIRITS PRODUCED BY HIM, HE SHALL, FROM ALL THE EVIDENCE HE CAN OBTAIN, DETERMINE WHAT QUANTITY OF SPIRITS WAS ACTUALLY PRODUCED BY THE DISTILLER AND AN ASSESSMENT SHALL BE MADE FOR THE DIFFERENCE BETWEEN THE QUANTITY REPORTED AND THE QUANTITY SHOWN TO HAVE BEEN PRODUCED AT THE RATE OF TAX IMPOSED BY LAW FOR EVERY PROOF GALLON. * * *"

The following provision of the Regulations, based on the above provision and in effect at the time of the loss, is most important:

> "The product for which the distiller is entitled to receive credit as against the required product under the survey is that quantity of finished spirits deposited in the cisterns in the cistern room by or before midnight of the last day of the month and cannot include any unfinished spirits remaining outside the cistern room at the close of the month". (Regulations 8, page 51.)

26 U. S. C. A. 1198 (Sec. 2847 I. R. C.) affords relief to distillers for failure to produce the required percentage and for use of excess materials in certain cases but these provisions are not material for there was no deficiency in production or excess materials used. As held by the Court, the assessment was not made under above Section 1197. This being true, it must be accepted that petitioner fully accounted for all spirits produced during August, 1936, including the spirits lost for such loss was duly reported.

The loss did not result in a deficiency. Had this occurred, petitioner would have been assessed for such deficiency, not the loss, and petitioner would have been compelled to seek relief under Section 1198 which probably would have been denied because of the negligence involved.

The purpose of the distillers record and monthly return was to enable the Commissioner to determine three things, namely, (a) that the distiller had produced the required 80 per centum of the surveyed capacity; (b) that he had accounted in spirits for any excess materials used, and (c) that he had accounted for *all* the spirits produced. Under Section 1197 the account is used as the basis for two assessments, (a) for any deficiency and use of excess of materials, and (b) failure to show all spirits produced. The account might show correctly all spirits produced but if there was a deficiency, there would be an assessment. Likewise there might be an over-production but if all the spirits were not accounted for, there would be an assessment.

Under the Act of June 26, 1936 (Appendix, p. 23, footnote) authorizing the Secretary to waive the survey requirements (26 U. S. C. A. 1168; Sec. 2817 (b) I. R. C.), the Secretary was also authorized to relieve the distiller from such requirements of above Section 1197 "and of such other provisions of law relating or incidental to survey requirements" as might be waived without danger to the revenue. The fact that the account was not to be confined to the purpose of determining deficiencies and use of excess materials, is shown by the action taken by the Secretary pursuant to the above authority. By above regulation (T. D. 4794) issued March 11, 1938, he not only waived the survey requirement but also relieved distillers from the possibility of being assessed for deficiency and use of excess material, as follows:

> "(d). From so much of the provisions of * * * (U. S. C. A. 1934, Ed. Title 26, Sec. 1197), as makes the

> distiller liable to an assessment for a deficiency in producing less than 80 per centum of the producing capacity of the distillery as estimated according to law; and as make him liable to an assessment for the tax upon the spirits that should have been produced from the material found to have been used in excess of the capacity of the distillery for any month as estimated according to law".

The distiller was not relieved from keeping the record and making his monthly return. The Commissioner was still required to examine the account and determine whether the distiller had accounted for all the spirits produced and if he failed to do so make an assessment for the difference between the quantity reported and the quantity shown to have been actually produced. The only remaining purpose of the account was to show the production and disposition of all spirits in the distillery and if all spirits were accounted for, no assessment was to be made. The return of a distiller serves the same purpose as the return required from any other person subject to excise taxes and heavy penalties are imposed for making a false or fraudulent return.

The reason for having the tax attach to alcohol as soon as this substance comes into existence as such was undoubtedly to establish the lien at that point, the purpose of the lien being, of course, to secure payment of the tax. The lien, very comprehensive in scope, continues until the tax is paid. If, however, the tax is not to be paid, as in the case of certain authorized withdrawals without payment of tax, the lien does not continue although there is no specific provision of law to this effect. Alcohol which has come into existence as such in a distillery may be further redistilled, separated as pure or impure spirit, transferred into other substances either "in the process of original production or by any subsequent process" (26 U. S. C. A. 1150 (c); Sec.

2800 (c) I. R. C.) (Appendix, p. 20). The alcohol may be used in the distillery for the production of gin, as in the instant case, without payment of the rectification tax (26 U. S. C. A. 1150 (a) (6); Sec. 2800 (a) (5)) or it may be reduced in the cisterns and taxpaid in the cistern room without being removed to the warehouse (Sec. 2883 I. R. C.) all of which indicates that whether or not the lien continues will depend on an ultimate accounting of the spirits.

It must be emphasized, however, that the tax does not become due, payable, collectible or assessable until the spirits are "withdrawn from bond". Petitioner agrees with the decision of the Court that the spirits in question were not withdrawn from bond but does not agree with the decision that the loss of the spirits in the distillery constituted a "removal from the place where distilled" and that the tax thereby became due under Section 1150 (b).

Petitioner has been unable to find any case or decision of the courts on the questions and points here presented. There are a number of decisions relating to losses sustained *in warehouse* and losses resulting in deficiency assessments but these have no direct application to the loss involved here. A word, however, must be said regarding the decision in *Seagram* v. *Smith, Collector,* 113 F. (2d) 357, an action previously instituted by petitioner involving a similar loss of whiskey. In that case, petitioner's employee failed to properly adjust the valves resulting in an overflow of whiskey from one of the cistern room tanks. The Circuit Court gave serious consideration as to when the production or distillation of spirits in a distillery is completed but found that "distillation was complete in the instant case and the tax liability attached". In holding that "The loss was one for which plaintiff must be held responsible", the Circuit Court did not point to the taxing provision under which the assessment was made, as the Court of Claims has done in this case, but referred to certain de-

cisions in support of its conclusions all of which can readily be distinguished from the case at bar and, although the objection may now appear to be somewhat late, had no application to the case before the Circuit Court. *U. S.* v. *Sisk,* 176 Fed. 85, was an action on the distiller's bond for failure to pay the tax within the statutory period; the spirits had been seized by the Collector and subsequently lost. The Court held that it was not necessary to show that the distiller had removed the spirits for the tax had not been paid within the period prescribed by law. *U. S.* v. *Cole,* 134 Fed. 697, was an action for the recovery of tax on brandy based on Section 1197 for failure to account, it having been shown that brandy had been produced from excess materials used. *Hart* v. *U. S.,* 95 U. S. 316, was an action on a distiller's bond, the Collector had allowed the distiller to remove spirits from the distillery without payment of the tax and judgment was allowed against the surety on the bond because such spirits had been removed without payment of tax and that the Government could not be held responsible for the wrongful acts of its officers.

The decisions referred to in the opinion of the Court of Claims (R. 10) can also be distinguished from the case at bar. In *Greenbrier* v. *Johnson,* 88 Fed. 638, and *Hamilton* v. *Kentucky, etc.,* 288 Fed. 326, there had been an actual and physical removal of the spirits. In *Mason* v. *Peabody,* Fed. Case No. 9250, decided in 1871, there was an assessment for deficiency because of loss due to leakage and fire and the distiller had failed to account for such spirits and judgment for the deficiency was granted. This decision was rendered prior to the Act of May 28, 1880 (26 U. S. C. A. 1198) allowing relief because of fire.

III.

The Court erred in holding that if 26 U. S. C. A. 1197 were applicable, petitioner is entitled to relief only if the spirits were lost without negligence on its part.

The argument set forth under "D" above is referred to in support of the above contention.

Respectfully submitted,

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